No. 15349

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JEFFERSON STANDARD LIFE INSURANCE COMPANY, a corporation,

Appellant,

vs.

UNITED STATES OF AMERICA, H. L. BYRAM, County Tax Collector of Los Angeles County, and GEORGE T. GOGGIN, Trustee of Stockholders Publishing Company, Inc., a corporation, bankrupt,

Appellees.

Reply Brief of George T. Goggin, Trustee of Stockholders Publishing Company, Inc., a Corporation, Bankrupt.

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Appellant's Opening Brief points out the two important questions presented on this appeal:

1. The problem of so-called "circular priorities";
2. The problem of allowance of post bankruptcy interest on secured claims.

We will attempt to give support herein to the first point mentioned hereinabove and George T. Goggin, trustee, respectfully contends that the Order of Referee David B. Head which fixed the manner of distribution of the sales

proceeds funds to the secured creditor Jefferson Standard Life Insurance Company, to the United States of America and to H. L. Byram, County Tax Collector of Los Angeles County, was correct. The said Order (and Supplemental Order) was affirmed on review by United States District Judge William M. Byrne and is here on appeal by Jefferson Standard Life Insurance Company.

We do not mean to imply that the interest controversy is not important. On the contrary, we believe it is by far the most important matter that bankruptcy administration in this District has been confronted with in the past ten years. However, it would appear that prior to the time of the hearing on the within appeal, the particular issue of post bankruptcy interest on secured claims will have been already determined by this Honorable Court in the appeal No. 15105 of Palo Alto Mutual Savings and Loan Association, Appellant, v. Ralph E. Williams, trustee of the estate of John E. Driskin, Bankrupt. The said appeal having been originally presented with oral argument and taken under submission; thereafter the submission having been set aside and the reargument has been reset before the court in banc.

We believe it is reasonable for us to assume that this Court will therein determine whether or not the law as established by this Court in 1946 in the case of *United States v. Sampsell,* 153 F. 2d 731, which allowed interest to date of payment (where the proceeds of security were ample for that purpose) and not to date of bankruptcy, was overruled by reason of the determination of the United States Supreme Court in its case of *Vanston Bondholders Protective Committee v. Green,* 329 U. S. 156, 91 L. Ed. 162, 67 S. Ct. 237.

This Court in the case of *Beecher v. Leavenworth State Bank* (1951), 192 F. 2d 10, stated at page 14, note 4:

> "Our decision in United States v. Sampsell, 9 Cir., 153 F. 2d 731, allowing post-bankruptcy interest on a secured claim where the proceeds of the security were ample for that purpose was necessarily overruled by the Supreme Court in the Vanston case which followed the Sampsell case."

We therefore reserve herein our comments on the interest point involved and reserve in our oral argument herein the presentation of our views thereon which will be in accordance with the Court's determination in the *Palo Alto* case.

The Problem of Circular Priorities.

The Referees held that in point of time the liens rank as follows [Memorandum of Referee dated January 6, 1956, Tr. p. 17]:

> "First, Jefferson; second, the United States; and third, the County of Los Angeles. The lien of the United States attached upon the receipt by the Collector of the assessment list on March 14, 1952, Sec. 3671, Internal Revenue Code of 1939. The lien of the United States is junior to the lien of Jefferson by reason of the provision of Section 3672, I. R. C., which excepts the lien of a mortgagee from the paramount lien of the United States. The lien of the County of Los Angeles is effective as of the date of March 1, 1954. This lien is junior to the lien of the United States because relative priorities are governed by the rule of 'first in time, first in right.' United States v. City of New Britain, et al., 347 U. S. 81; California State Department of Employment v. United States (C. A. 9), 210 F. 2d 242. However, the lien of the County of Los Angeles, by

> California law, is superior to the lien of Jefferson. Dougherty v. Henarie, 47 Cal. 9; Courtney v. Byram, 54 Cal. App. 2d 769. . . . This court is faced with the anomalous situation where Jefferson's mortgage lien has priority over the tax lien of the United States, and the tax lien of the County supersedes the mortgage lien and the fund is insufficient to satisfy the claims of all three parties. . . ."

The appellant contends (on p. 7 of its Br.):

> "that the fund was sufficient to pay both appellant's claim and the County's claim in full. There was no conflict between appellant's lien is admittedly superior to the federal lien. There was no conflict between appellant's lien and the county's lien, because the fund was ample to pay both. The Referee should have ordered appellant's lien paid in full. *Conflicting claims to the surplus* would then arise between the County and the United States. The surplus should have been ordered paid to the United States, whose claim is superior to the County's claim by reason of its priority in time and the supremacy of federal law."

In point of time obviously the Jefferson encumbrances of 1945 were prior to the County of Los Angeles tax lien for 1954-1955 property taxes. However, the California cases relied upon by the Referee of *Dougherty v. Henarie,* 47 Cal. 9, and *Courtney v. Byram,* 54 Cal. App. 2d 769, we believe, fully support his Order that the tax lien is "superior" to the Jefferson lien. Quoting from the latter case at page 770:

> "By statutory provision and by the harsh law of necessity, taxes are a first lien upon property, and the obligation to pay taxes is superior to the obligation of private debts."

Superiority of County Tax Lien Over Contract Liens.

The County tax lien does not lose its superiority over private contract liens such as Jefferson's merely because the latter are prior to a federal tax lien.

It appears that the amount realized from the sale of the security was more than sufficient to pay Jefferson Standard's claim with interest to the date of payment, although it is not sufficient to pay all lien claims in full.

Jefferson Standard's lien is first in time, and it is undisputed that it is entitled to priority over the federal tax lien, notice of the federal lien not having been recorded until December 20, 1954. The federal lien precedes the lien of Los Angeles County in point of time.

Recognizing the priority of Jefferson Standard's lien, the Referee ordered payment of its claim in the amount of $351,223.74 (principal and interest to the date of bankruptcy).

Superiority of Liens of United States Over County Tax Liens.

In *United States v. City of New Britain,* 347 U. S. 81, 98 L. Ed. 520, 74 S. Ct. 367 (1954), the proceeds were not sufficient to pay all claims in full and although it was not shown that the corporation was insolvent, the Supreme Court held that the federal tax liens which arose in 1948 and 1950 were prior to the real estate tax liens which became due in 1947 through 1951 and "water rent liens" from 1947 to June, 1951. From the opinion at pages 86 and 87:

> "In the instant case, certain of the City's tax and water-rent liens apparently attached to the specific property and became choate prior to the attachment of the federal tax liens.

The State and the United States were both holders of general statutory liens in the Gilbert Associates case, United States v. Gilbert Associates, Inc., 345 U. S. 361, 97 L. Ed. 1071, 73 S. Ct. 701. But the question we have here did not arise there because that was a case involving personal property and insolvency of the taxpayer. We said in that case:

'Where the lien of the Town and that of the Federal Government are both general, and the taxpayer is insolvent, Section 3466 (Revised Statutes) clearly awards priority to the United Sttaes.' 345 U. S., at 366.

Here the contest is between two groups of statutory liens, one specific and one general, attached to the same real estate, with no question of insolvency involved; therefore, 'the first in time is the first in right.'

The State finds the rule of 'first in time, first in right' not applicable because of Section 3672 of the Internal Revenue Code, which makes the lien of the United States invalid as to the prior recorded mortgages and the judgment in this case. It points out that the mortgagee could have paid the delinquent real-estate taxes and water rent, with the amount so paid becoming part of the mortgage debt covered by the mortgage lien, and suggests that the federal tax lien would therefore be invalid as to such amount by virtue of Section 3672. From this and a belief that Congress did not intend, by giving mortgages and judgments priority over federal tax liens, to supersede state laws making certain interests superior to mortgages and judgments, the Supreme Court of Errors concluded that by enacting Section 3672 Congress 'expressed the intention that federal liens should be subordinated to such mortgages and judgment liens as are described therein and, consequently, subordi-

nated to such other incumbrances as have priority over those mortgages and judgment liens.

We do not agree. The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien. . . ."

In the case of *Smith v. United States,* 113 Fed. Supp. 702 (1953), the United States District Court, District of Hawaii, had before it the following situation, quite similar to the problem here presented (from the opinion at pp. 710 and 711):

"This Court is thus faced with the anomalous situation where Smith's mortgage lien has priority over most of the United States's tax liens, the bulk of the Territory's tax liens supersedes the mortgage lien and some of the United States's tax liens are prior to the Territory's liens, and where the escrow fund is insuffiicent to satisfy the claims of all three parties. Although cases in piont are meager, the few cases in existence are helpful as judicial guideposts.

In Ferris v. Chic-Mint Gum Co., 1924, 14 Del. Ch. 232, 124 A. 577, 580, under Delaware law, the state, county and city tax and sewer liens were given priority over the mortgage lien; the mortgage was recorded prior to the attachment of federal tax liens; and some of the federal tax liens antedated some of the state, county and city tax and sewer liens. The Delaware court resolved the problem by setting the following order of priority: first, state, county and city tax and sewer liens; second, mortgage lien; and third, United States tax liens. . . .

The highest court of Connecticut similarly resolved a tripartite priority problem in Brown v. General Laundry Service, Inc., 1952, 139 Conn. 363, 94 A. 2d 10. It reasoned that Congress, by subordinating federal tax liens to mortgage and judgment liens in 26 U. S. C., Section 3672, subordinated such federal liens to such other incumbrances having priority over those mortgage and judgment liens.

The first inkling as to another method of resolving the tripartite priority problem here involved appeared in Spokane County v. United States, 1929, 279 U. S. 80, 49 S. Ct. 321, 73 L. ed. 621. Although a third party mortgagee was not involved, Chief Justice Taft referred to the contention made by the United States in the Spokane County case and stated 279 U. S. at page 91, 49 S. Ct. at page 324:

'Moreover it is contended by the government that the relative priorities could have been maintained in that case (Chic-Mint Gum Co. case) by setting apart sufficient funds to pay the mortgage before paying the federal taxes and then providing for payment of the state tax out of the sum so set apart.'

After citing Chief Justice Taft's dicta, a circuit court of West Virginia adopted the solution suggested in the Spokane County case. In Hopkins v. Eureka Coal Co., 1944, 33 Am. Fed. Tax Rep. 1627, the court ruled that the order of priority was first, mortgage liens; second, United States tax liens; and third, West Virginia tax liens. However, the amounts due the mortgagees were ordered set apart to permit West Virginia to first satisfy its liens from such amounts.

. . .

This court feels that the resoult reached in the Eureka Coal case is the fairest. The Eureka Coal solution maintains the relative priorities established by the local and federal statutes, where as the Chic-

> Mint Gum rule arbitrarily ignores the principle of 'first in time, first in right' which should apply to the general liens of the local and federal governments. . . ."

Applying the rule of the *Eureka* case the Court thereupon ordered paid: 1. the United States lien which was prior in point of time; 2. the payment of the mortgage obligation; 3. various United States liens which were subsequent to the mortgage. *And, from the fund set aside for the mortgage that the tax claim of the Territory be paid.*

The United States admits that the mortgage lien is prior to its liens. Therefor the Order as here on appeal takes nothing from it so long as the disbursement prior to its participation is the equivalent of the Jefferson obligation. The County Tax Collector is receiving payment of his tax lien in the manner indicated from the Order. His argument and contentions that he should receive payment before the prior United States tax liens have never seemed to us to carry much weight or have any legal support. If he is not paid in the manner as provided in the Order, we see no theory upon which he can be paid from the fund derived from the sale of the security, if he cannot receive payment from any portion of the fund remaining over the mortgage payment which most certainly is claimed by the Director of Internal Revenue.

However, Jefferson Standard asserts that it is prior in all respects to the United States and that the rule of distribution should work in its favor and not in favor of

the position of the United States. In other words, while it does not concede that the County Property tax is ahead of its lien, it takes the position that if the County is to be paid, the payment should be made from the funds over and beyond the payment of its lien and in effect out of the amount allocated to the United States.

This Court in 1953 decided the case of *United States v. Division of Labor Law Enforcement,* 201 F. 2d 857, and while the case is upon a different state of facts, we nevertheless believe it has application herein as much as it determined a matter of distribution and priority.

The facts in this case are comparatively simple. A General Assignment for Benefit of Creditors was made by a debtor. Labor claimants asserted their lien claims which arose at the instant of the Assignment against the assets under California Code of Civil Procedure, Section 1204. The United States asserted tax claims for priority of payment under 31 U. S. C. A., Section 191, at the same instant and we believe that the following syllabus of the reported case reflects the views set forth therein:

> "A state statute purporting to create a lien at the very instant federal priority arises is incompatible with the federal statute establishing the priority, and where such conflict exists, the supremacy of the federal law must be recognized. 31 U. S. C. A., Section 191; U. S. C. A. Const. art. 6, cl. 2."

Following the expression as set forth herein, the trustee respectfully expresses the view that: 1. there is no manner or method of law by which one cent can be taken from the fund of the United States (*i.e.*, the residue

after a payment of the equivalent of the Jefferson Standard Lien) to pay the County Tax which lien is junior; 2. that the County Tax must be paid before the mortgage obligation is paid; 3. that the Order of the Referee and United States District Judge be affirmed.

Respectfully submitted,

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